

1940.
NEW ZEALAND.

RESERVE BANK OF NEW ZEALAND.

ANNUAL REPORT OF THE BOARD OF DIRECTORS AND STATEMENT OF ACCOUNTS FOR THE YEAR
ENDED THE 31st MARCH, 1940.

Presented to both Houses of the General Assembly pursuant to Section 20 of the Reserve Bank of New Zealand Amendment Act, 1936.

ANNUAL REPORT.

To the Hon. the MINISTER OF FINANCE.

THE Board of Directors reports as follows on the operations of the Reserve Bank during the financial year ended the 31st March, 1940.

After making such provision as the Board thinks proper for rebate on unmatured Treasury Bills and for depreciation in other assets, the net profit for the year totalled £361,363 6s. 10d. This amount has been paid into the Public Account to the credit of the Consolidated Fund in accordance with the requirements of the Reserve Bank of New Zealand Amendment Act, 1936.

Expenditure increased during the year by approximately 43 per cent. as compared with the previous year. The main factor in this increase was the higher cost of the note issue, whilst salaries and office accommodation also accounted for larger sums. As regards the note issue, the necessity of laying in larger supplies of bank notes coincided with the introduction of the new issue, and, in addition, there was a marked increase in transportation costs. The increase in salaries was caused partly by additions to the staff in order to deal with the expanded functions of the Bank, and partly by normal increases to the staff generally.

On the other hand there was a marked increase in revenue, occasioned mainly by the considerably higher level of advances to the State throughout the year, which was much more than sufficient to counteract the reduction in the rate charged by the Bank for this accommodation. The yield on sterling funds was also greater than in the previous year.

The principal changes in the balance-sheet, compared with the figures of the previous year, were as under :—

LIABILITIES.

Bank Notes.

The total of the notes outstanding at the end of the financial year (£18,284,757) was approximately £3,000,000 higher than the corresponding figure last year : this was accounted for in part by the fact that Easter fell in the latter part of March this year, and the circulation therefore reflected the usual demand for notes for that holiday period. However, both the total of the notes outstanding and the effective note circulation were consistently higher throughout the year than in the previous year, the weekly average of the latter being £12,635,999 as against £10,364,124.

Demand Liabilities.

(a) *State* : The increase of approximately £2½ million represents to a large extent sums awaiting disbursement from the Wool Account to growers to which reference is made below.

(b) *Banks* : The increase of approximately £6,100,000 resulted in the main from the increase in advances to the State by the Reserve Bank, as the trading banks are now unable to reduce the amount of their balances by buying sterling from the Reserve Bank except to cover remittances on behalf of their customers for licensed imports and other authorized purposes.

No action was taken by the Bank under section 23 of the Reserve Bank of New Zealand Amendment Act, 1936, to raise the percentage of the statutory minimum balances of the trading banks. These minimum balances aggregated £1,245,994 at the 31st March, and their free balances therefore amounted to £10,198,611.

ASSETS.

Sterling Exchange.

The increase of £8,794,294 16s. 8d. in the Bank's holding of sterling exchange is accounted for partly by the proceeds of the bulk of the Dominion's exports under war-time arrangements with the United Kingdom Government being received at a much earlier stage than heretofore, and partly by delays in deliveries of imported goods beyond the months for which authority to remit in payment for them was authorized by the Reserve Bank.

This subject is dealt with more fully later in this Report.

*Advances.**(a) To the State or State Undertakings :*

- (1) *Marketing Department :* Marketing Department advances as a whole declined by £3,708,821 10s. 6d., although the transactions now embrace a wider range of commodities than was the case prior to the war. This development is another consequence of the new basis on which the Dominion's exports of dairy-produce, meat and wool are purchased by the Government of the United Kingdom.

Before the war, dairy-produce was the only export commodity financed by advances from the Reserve Bank, and the sterling proceeds were not received by the Bank until many weeks after the corresponding disbursements had been made to the producers in New Zealand. The advances then represented partly produce in transit or awaiting sale in London, and partly the accumulated deficit in the Dairy Industry Account consequent upon disbursements in New Zealand on the basis of guaranteed prices not being fully covered by subsequent realizations overseas.

The new arrangement for dealing with the wider range of exports, besides being based on prices which do not entail the accumulation of further deficits, provides for payment to the producers by methods which involve only small temporary advances in respect of dairy produce and meat, whilst the Wool Account was actually maintained in a credit position.

The following agreements are now in force for the sale of certain commodities to the United Kingdom Government :

- (i) *Dairy Produce :* The United Kingdom Government are to purchase 115,000 tons of the exportable surplus of New Zealand butter and 84,000 tons of the exportable surplus of New Zealand cheese for the 1939-40 season. Additional quantities will be taken if required by the United Kingdom and if shipping space is available. The agreed prices for the 1939-40 season average 112s. 3d. sterling per hundredweight f.o.b. New Zealand for butter, and 64s. 2d. sterling per hundredweight f.o.b. New Zealand for cheese, the equivalent New Zealand prices being 139s. 7½d. and 79s. 9d., respectively.

Exporters are paid in New Zealand on shipment at current prices guaranteed by the New Zealand Government, and 90 per cent. of the purchase price is paid forthwith to the Bank's agent in London, the balance being received within twenty-eight days after arrival of the produce at its destination, or, if the shipment is lost in transit, within that period after what had been the estimated due date of arrival.

- (ii) *Meat :* The United Kingdom Government are to purchase 300,000 tons of the exportable surplus of New Zealand frozen meat during the 1939-40 season at agreed prices, exporters receiving payment in full on shipment less ½ per cent. deducted to cover expenses. Arrangements as to further quantities, and as to payment in London, are the same as for dairy produce.

- (iii) *Wool :* The United Kingdom Government are to purchase the exportable surplus of wool for the duration of the war and for one complete season's clip thereafter.

The agreed f.o.b. price is 10-55d. sterling per pound for greasy wool, the net average yield to producers being 12-25d. New Zealand currency per pound delivered at brokers' stores, while slipe wool realizes 13-75d. sterling per pound with an average gross return of 16-9766d. New Zealand currency per pound to growers. The prices paid in London are on the basis of a flat rate irrespective of variations in quality, but prices paid to growers in New Zealand are graded according to quality. The prices mentioned above relate only to the current season's clip.

Payment in full is received in London by the Reserve Bank within a few days after the wool has been appraised in New Zealand, whereas payment in New Zealand is made to the extent of 95 per cent. for greasy wool and 90 per cent. for slipe wool on the "prompt date," which is fourteen days after appraisal. The balance is held in suspense till the end of the season to cover possible variations between estimated and actual quantities of each class of wool appraised. In consequence of this arrangement, considerable credit balances are held in the Wool Account at the Bank pending payment on prompt date and the ultimate distribution of the small margin held in suspense.

Should any of the wool purchased by the British Government be re-sold outside the United Kingdom and France, one-half of any profits realized will accrue to New Zealand.

- (2) *For Other Purposes :* The advances under this heading increased by £6,735,000 during the year. Of the total amount outstanding at the end of the year, £10,400,000 represented advances for housing purposes.

The rates ruling on the 31st March, 1940, for this accommodation were as follows : 1 per cent. for the first £5,000,000, 2 per cent. for the next £5,000,000, and 3 per cent. for the balance. And as only 1 per cent. was being charged on advances to the Marketing Department up to a total of £5,000,000, it was possible for the Government to borrow up to £25,000,000 from the Bank at an average cost of 2 per cent. per annum.

DISCOUNT RATE.

The discount rate, which had remained at 4 per cent. since the 19th November, 1938, was reduced to 3 per cent. on the 6th September, 1939, shortly after the outbreak of war.

EXCHANGE RATE.

The Bank's buying rate for sterling remained unchanged, but since the suspension of the obligation to redeem notes in sterling no selling rate has been quoted.

No alterations in the trading banks' telegraphic transfer rates for sterling were made during the year, either for buying or selling, but some small adjustments in the time rates were announced in September and later in December to meet changing circumstances.

BANK NOTES.

A new issue of bank notes was released for circulation on the 6th February, 1940, and thus coincided with the Centennial celebrations. Although the new notes embody certain historical features of special interest, they are not intended to be primarily a commemorative issue, but to replace gradually the original issue which was always regarded as of a temporary nature.

The new notes differ considerably from the old ones, both in size and design, and contain certain features which have been incorporated with a view to affording the maximum protection to the currency. The range of denominations has been widened by the addition of £10 notes; and distinctive colours and gradations of size have been adopted with a view to rendering the various denominations easily distinguishable.

The 10s. and £1 notes were reduced to what were considered to be more convenient sizes for the public; and although the £10 and £50 notes are of the same dimensions, it is considered that the marked distinction in colouring, in addition to the wide difference in the designs on the backs of those notes, should obviate the possibility of there being any confusion between these two denominations.

Despite the introduction of the new issue, the public were informed that the notes of the original issue are expected to remain in circulation for some time, and they have been requested to assist in prolonging the life of all notes in circulation as much as possible as a war-time measure of economy.

MANAGEMENT OF PUBLIC DEBT.

During the year the Bank undertook the issue of an internal loan of £4,500,000, the lists of which were closed on the 31st May, 1939. The loan was over-subscribed.

Investors were offered the following alternatives :—

- (a) 4-per-cent. Stock due 31st May, 1958, the Government having the option to redeem at par at any time after the 31st May, 1954, on giving three months' notice. The issue price was £96 per centum. A condition attaching to this issue is that if the market selling price falls below the price of issue, sums will be made available annually, as required, up to a total of 5 per cent. of the amount of the loan outstanding at the end of the previous financial year, towards the purchase for cancellation of any such stock on offer below that price. No other stock in New Zealand carries this provision.
- (b) 4-per-cent. Stock maturing on 30th November, 1948, the issue price being £99 per centum. This stock will be accepted at par at any time before maturity in payment of death duties in respect of the holder's estate provided that such stock has been in the beneficial ownership of the holder for at least six months prior to death.

The public favoured the longer-dated issue, as is shown by the amounts of the respective stocks allotted :—

	£
1948	1,413,390
1954-58	3,086,610
	<hr/>
	£4,500,000

Commencing with this issue, the fees previously charged for transfers and for the issue of certificates of title of Government stock domiciled in the Dominion were abolished.

These concessions should help to popularize Government Stock with the general public and facilitate dealings, especially in small holdings.

STATE ADVANCES CORPORATION.

The list of applications for the 3½-per-cent. Guaranteed Stock or Debentures (Series B) due 1st June, 1941, which had been on offer since the 15th February, 1937, was closed on the 30th May, 1939.

EXCHANGE CONTROL.

The most important developments in the operation of exchange control during the year arose out of a shortage of funds available overseas to meet the current demand for remittances in respect of licensed imports and for other authorized purposes.

It therefore became necessary to introduce in July a system of deferred remittances covering all requirements for overseas funds, with the exception of those for Government purposes and for the service of Local Body debt domiciled abroad. Under this arrangement, holders of import licenses who applied to the Reserve Bank were granted " Exchange Authorities " specifying the months during which payment could be made overseas, and those who had occasion to remit funds overseas for other purposes were granted " Exchange Permits " in a similar manner provided the object of their remittance was approved.

These arrangements involved, firstly, making estimates of the prospective receipts of overseas funds from all sources during the period concerned and, secondly, fixing a basis for spreading payments in such a way as to give a measure of preference to exporters in the United Kingdom and other parts of the Empire, while at the same time ensuring the early delivery of the goods most urgently needed in the Dominion.

By the end of December, deferred payments totalling approximately £(N.Z.)16 millions had been spread over the first six months of 1940 in respect of licenses which were granted originally for the importation of goods during 1939; but, as part of this arrangement, the expiry date of licenses originally valid for the second half of 1939 only, was also extended to the 30th June, 1940, and about half of the above amount was in respect of such licenses for which remittances had not been made by the end of 1939.

It was recognized that the deferring of payments for imports introduced the possibility of uncertainty as to the amount of sterling which might ultimately be purchased with the amount of New Zealand currency allocated; and, in order to meet this difficulty, the trading banks were authorized to sell sterling forward at the official rate to cover amounts for which deferred Exchange Authorities had been given, provided that the relative goods had been placed on board ship in the exporting country, and subject to certain other requirements.

When making the above alterations in the procedure for dealing with remittances for imports, a change was made also in the arrangements for the issue of Permits in respect of private remittances for other purposes.

Until July, 1939, the granting of a permit merely signified the Reserve Bank's approval of the relative remittance being made by the trading bank concerned, if and when overseas funds were available. The altered procedure, however, provided that the remittance could be made during a specified month.

Having regard to the extent to which import licenses were issued, the above-mentioned basis for allocating funds overseas was expected to preclude any material increase in the combined overseas resources of the Reserve Bank and the trading banks; but certain consequences of the outbreak of war in September, 1939, resulted in a considerable increase in those resources, as is shown by the following table:—

Date.		Reserve Bank.	Trading Banks.	Total.
(000 omitted.)				
		£	£	£
27th March, 1939	..	4,626	4,646	9,272
25th March, 1940	..	13,021	9,988	23,009
Increase	..	8,395	5,342	13,737

This increase was due almost entirely to payment for the principal exports being received earlier than was anticipated, to which reference is made above, and also to the delay in the arrival of licensed imports in respect of which Exchange Authorities had been issued.

These developments could not, of course, be foreseen when a large part of the exchange allocations for 1939 imports were spread over the first half of 1940; but when it was found that overseas funds in respect of which Exchange Authorities had been granted were accumulating to a greater extent than could be availed of by the holders of such Authorities, the trading banks were authorized to provide without further delay for the remittance of any payments which had been deferred beyond their normal due date.

Thus, the holdings of overseas funds at the end of March in excess of reserve requirements represented amounts earmarked for importers but not yet availed of; and it ceased to be necessary to delay remittances beyond the normal date of payment for imports.

TRADING BANKS.

There were several noteworthy changes in the trading banks' figures at the end of March, 1940, as compared with those at the end of the previous year.

Demand and time liabilities increased by £9½ millions, of which £8 millions was in demand deposits. Variations in their assets included a decrease of £7½ millions in advances and discounts, and increases of £6½ millions in Government securities, £5·3 millions in net overseas assets and £4 millions in cash. The increase in overseas assets, however, represented sums held for account of the Reserve Bank, and was more than covered by outstanding Exchange Authorities.

Unexercised overdraft authorities stood at £28·8 millions, which showed an increase of £5·3 millions.

POST OFFICE SAVINGS BANK.

Fresh sums deposited in the Post Office Savings Bank, excluding accrued interest, amounted to £25·2 millions for the year and withdrawals to £29·5 millions as compared with £30·4 millions and £34·6 millions, respectively, for the previous year. At the end of March, 1940, the total amount, including interest, standing to the credit of depositors was £58 millions, the figure for March, 1939, being £60·7 millions.

BUSINESS ACTIVITY.

In general, production, business activity and employment were fairly well maintained throughout the year, a falling-off in some kinds of business unfavourably affected by import restrictions being offset by an expansion of local manufacturing industries. The following is a comparison of the figures for trading bank debits, net note circulation and sales tax receipts for the past three years, ended 31st March, respectively :—

	1938.	1939.	1940.	Percentage Change 1940 over 1939.
(£(N.Z.) millions.)				
Trading bank debits (excluding Government) ..	962.4	942.9	962.1	+ 2
Note-circulation (weekly average held by public)	9.1	10.4	12.6	+22
Sales-tax receipts	3.519	3.572	3.521	— 1.4

EXTERNAL TRADE.

During part of the year under review, economic trends in New Zealand were affected by the war. It is useful, therefore, to divide the survey of trade and industry into two sections dealing respectively with the periods April–August and September–March.

As shown in the following table, both export and import values were slightly higher, and the balance of trade lower during the first period than for the corresponding period of the previous year. During the second period there was a still greater relative increase in export values, a substantial fall in import values and a large increase in the balance of trade. This was due to a rise in export prices following the outbreak of war, and to a very considerable fall in the quantities of goods imported which more than offset the rise in prices overseas and the increased costs of sea transport and insurance.

	Exports.	Imports.	Excess of Exports over Imports.
(£(N.Z.) millions.)			
First Period (April–August)—			
1938	24,338	21,895	2,443
1939	24,372	22,566	1,806
Second Period (September–March)—			
1938–39	33,529	32,513	1,016
1939–40	35,271	23,005	12,266

The effect of selective import control is shown by considerable decreases in manufactured commodities such as ready-made clothing, footwear, fancy goods and motor vehicles and parts. Imports of iron and steel, electrical goods and machinery also decreased substantially. Comparatively few items, mainly foodstuffs and producers' materials, including sugar, tea, piece goods, bags and sacks, and motor spirit, showed increases.

The following table sets out some of the noteworthy changes :—

	Year Ended 31st March,				Percentage Change 1940 over 1939.	
	1939.		1940.			
	Quantity.	Value.	Quantity.	Value.	Quantity.	Value.
	(000 omitted.)					
		£(N.Z.)		£(N.Z.)		
Motor Vehicles	31	5,204	17	2,818	—45.2	—45.9
Motor Spirit	98,977 gals.	1,796	93,577 gals.	2,030	— 5.5	+13.0
Tobacco (unmanufactured) ..	2,884 lb.	323	5,481 lb.	542	+90.0	+67.8
Tobacco (manufactured) ..	1,084 lb.	256	358 lb.	82	— 67.0	— 68.0
Apparel .. .. .	..	1,348	..	344	..	—74.5
Footwear	224 doz. pr.	583	105 doz. pr.	222	—53.1	61.9
Bags and sacks .. .. .	..	302	..	597	..	+97.7
Cotton, linen and silk piece goods .. .. .	..	2,397	..	2,681	..	+11.8
Floor coverings .. .. .	..	697	..	421	..	+39.6
Iron and steel	2,523 cwt.	2,709	1,616 cwt.	2,001	—35.9	— 26.1
Electrical goods .. .. .	..	2,891	..	2,343	..	—19.0
Sugar	1,916 cwt.	711	1,887 cwt.	969	— 1.5	+36.3
Tea	11,362 lb.	827	12,092 lb.	989	+ 6.4	+19.6

Comparing the whole year ended 31st March, 1940, with that of 1939 there was an increase of £(N.Z.)1.8 millions in export values, a decrease of £(N.Z.)8.8 millions in import values and a rise of £(N.Z.)10.6 millions in the excess of exports over imports.

The principal changes in quantities and values of exports are as follows :—

				Year ended 31st March,		Percentage Change 1940 over 1939.			
				1939.		1940.			
				Quantity.	Value.	Quantity.	Value.	Quantity.	Value.
				(000 omitted.)					
				£(N.Z.)		£(N.Z.)			
Wool	..	..	..	814 bales	11,946	790 bales	12,640	3	+ 6
Meat—									
Lamb	..	..	..	2,674 cwt.	9,186	2,818 cwt.	9,367	+ 5	+ 2
Mutton	..	..	..	1,015 „	1,910	1,294 „	2,155	+ 27	+ 13
Beef	..	..	..	979 „	1,724	828 „	1,461	— 15	— 15
Pork	..	..	..	542 „	1,791	415 „	1,422	— 23	— 21
Dairy Produce—									
Butter	..	..	..	2,444 „	15,887	2,412 „	16,345	— 1	+ 3
Cheese	..	..	..	1,647 „	6,152	1,674 „	6,094	+ 2	— 1
Other	..	..	..	..	9,271	..	10,160	..	+ 10
Total	..	..	..	..	57,867	..	59,643	..	+ 3

COMMODITY PRICES.

In general the prices of the chief exports were on a lower level for the period April–August than for the corresponding period of the previous year ; but they rose after the outbreak of war, the main increases, as shown below, occurring in the prices of wool and pastoral produce other than dairy produce and meat :

Export Price Index Numbers.
(Base 1909–13 = 1000.)

—	All Exports.	Wool.	Meat.	Dairy Produce.	Other Pastoral Produce.
March, 1939 ..	1330	1104	1672	1239	850
March, 1940 ..	1561	1492	1831	1331	1484
Increase ..	17·4 per cent.	35·1 per cent.	9·5 per cent.	7·4 per cent.	74·6 per cent.

During the first period (April–August) the all-groups index number of wholesale prices rose by 3¼ per cent., imported items rising by 2½ per cent., and locally-produced items by 4 per cent. During the second period (September–March) wholesale prices rose generally by over 6 per cent., the increase being almost entirely due to a rise of about 11 per cent. in the index number of prices of imported items, while the prices of locally-produced items rose only slightly.

Retail prices, the index number of which includes rent, as well as food, clothing, drapery, footwear, fuel, light and a large number of miscellaneous items, showed a slightly rising tendency throughout the year, the increase during the first period being 3 per cent. and that of the second period being not quite 2 per cent.

The following table shows the monthly changes in the index numbers of wholesale and retail prices :—

(Base 1926–30 = 1000.)

—	Wholesale.			Retail, all Groups.
	Imported Items.	Locally Produced Items.	All Groups.	
1939.				
March	1066	1029	1050	966
April	1067	1041	1056	972
May	1066	1043	1057	983
June	1069	1043	1058	983
July	1070	1058	1065	987
August	1093	1071	1084	995
September	1097	1049	1077	995
October	1109	1064	1090	997
November	1124	1094	1111	1026
December	1136	1087	1115	1019
1940.				
January	1154	1073	1120	1008
February	1176	1077	1135	1013
March	1211	1073	1153	1012
Increase March, 1940, over March, 1939	13·6 per cent.	4·3 per cent.	9·8 per cent.	4·8 per cent.

The Commodity Price Index Numbers used in this Report are those compiled and published officially by the New Zealand Government Statistician.

STAFF.

The staff has continued to meet in a highly satisfactory manner all the demands which have arisen from the increased activities of the Bank.

A few months after the outbreak of war, a spontaneous request was made by the members of the male and female staff, both permanent and temporary, that any overtime which might become necessary should be regarded as voluntary war service and that no payment should be made for any such work. This generous offer was accepted by the Board as evidence of the splendid spirit of service by which the staff is actuated.

For and behalf of the Board of Directors,

June, 1940.

L. LEFEAUX, Governor.

W. F. L. WARD, Deputy Governor.

PROFIT AND LOSS ACCOUNT FOR YEAR ENDED 31ST MARCH, 1940.

<i>Dr.</i>	£	s.	d.	<i>Cr.</i>	£	s.	d.
General charges, including salaries, rent, cost of note issue, and other expenses	155,300	10	2	Balance of profit after making provision for rebate on Treasury Bills not yet due, and for sundry liabilities and contingencies	516,663	17	0
Balance, being profit for year	361,363	6	10				
	<u>£516,663</u>	<u>17</u>	<u>0</u>		<u>£516,663</u>	<u>17</u>	<u>0</u>

PROFIT AND LOSS APPROPRIATION ACCOUNT.

<i>Dr.</i>	£	s.	d.	<i>Cr.</i>	£	s.	d.
Payments to New Zealand Government in terms of section 36 of Reserve Bank of New Zealand Act, 1933	250,285	10	4	Balance at 1st April, 1939	250,285	10	4
Balance	361,363	6	10	Balance from Profit and Loss Account	361,363	6	10
	<u>£611,648</u>	<u>17</u>	<u>2</u>		<u>£611,648</u>	<u>17</u>	<u>2</u>

BALANCE-SHEET AS AT 31ST MARCH, 1940.

<i>Liabilities.</i>	£	s.	d.	<i>Assets.</i>	£	s.	d.
General Reserve Fund	1,500,000	0	0	Gold (at face value)	2,801,839	0	0
Bank notes	18,284,757	0	0	Sterling exchange	13,457,346	3	3
Demand liabilities—				Subsidiary coin	160,311	1	1
(a) State	6,855,559	2	9	Advances			
(b) Banks	14,444,605	10	9	To the State or State undertakings—			
(c) Other	252,095	10	11	(1) Marketing Department	3,526,640	4	8
Liabilities in currencies other than New Zealand currency	8,238	0	2	(2) For other purposes	18,960,000	0	0
Other accounts	561,143	2	6	Investments	3,071,918	4	6
Profit and Loss Appropriation Account	361,363	6	10	Other assets	289,707	0	5
	<u>£42,267,761</u>	<u>13</u>	<u>11</u>	N.B.—Holdings of sterling have been converted into New Zealand currency at the rate of £100 sterling equals £124 New Zealand.			
					<u>£42,267,761</u>	<u>13</u>	<u>11</u>

L. LEFEAUX, Governor.

W. F. L. WARD, Deputy Governor.

W. R. EGGERS, Chief Accountant.

Auditors' Certificate and Report.—We have audited the balance-sheet as at 31st March, 1940, above set forth, and have obtained all the information and explanations we have required.

We have accepted the certificate of the Bank of England as to assets held on account of the Reserve Bank of New Zealand.

In our opinion the balance-sheet is properly drawn up so as to exhibit a true and correct view of the state of the affairs of the Bank as at 31st March, 1940, according to the best of our information and the explanations given to us and as shown by the books of the Bank.

J. L. GRIFFIN }
D. G. JOHNSTON } Public Accountants, Auditors.

Wellington, New Zealand, 7th June, 1940.

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